Supreme Court of the United States

OCTOBER TERM, 1940

No.

IN THE MATTER
of
DEEP ROCK OIL CORPORATION,
a corporation,
Debtor,

STANDARD GAS AND ELECTRIC COMPANY,
Petitioner,
against

JOHN M. TAYLOR, *et al.*, as the Preferred Stockholders Independent Committee, JOHN J. SHINNERS, *et al.*, as a Reorganization Committee of Deep Rock Oil Corporation, H. N. GREIS, Trustee of Deep Rock Oil Corporation, THE SECURITIES AND EXCHANGE COMMISSION, Intervenor, and DEEP ROCK OIL CORPORATION.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I. Opinions of courts below.

The oral opinion of the District Court is printed at page 1314 of the record. The opinion of the Circuit Court of Appeals for the Tenth Circuit is officially reported in 113 F. (2d) 266, and is printed in the record at pages 1372-1378.

II. Jurisdiction.

The decree of the Circuit Court of Appeals was entered on June 29, 1940 (R. 1378). The statutory provision which is believed to sustain the jurisdiction of this Court is Section 240 (a) of the Judicial Code as amended (28 U. S. C. A. Section 347).

III. Statement of the case.

The essential facts of the instant case have been stated in the foregoing petition, to which reference is respectfully made.

IV. Specifications of Error.

The District Court erred in its order of February 29, 1940 and the Circuit Court of Appeals for the Tenth Circuit erred in affirming the order because:

1. Under the substantially undisputed facts of the instant case and as a matter of law and equity, Standard is entitled to the allowance of its claim as a creditor of Deep Rock, and is entitled to participate in the reorganization of the Debtor as a creditor.

2. The claim of the note holders for $10,000,000 principal, plus $4,200,000 of interest at 6% per annum accrued during the receivership and reorganization proceedings, and the claim of the preferred stockholders for $100 per share ($5,000,000 in the aggregate) plus $3,150,000 of dividends thereon at the rate of $7 per share per annum accrued during the receivership and reorganization proceedings are not entitled to satisfaction in full before making any provision for Standard as a creditor.

3. To satisfy the claim of the note holders and the interests of the preferred stockholders to the extent above mentioned, particularly taking into consideration the low prices at which such securities were purchased during the receivership and reorganization proceedings, would unjustly enrich holders of Deep Rock securities at the expense of the fifty-eight thousand public security holders of Standard.

4. On the basis of the record, equity requires that the claim of Standard be allowed on a parity with the claims of the note holders of the Debtor at least to the extent of cash advanced by Standard between February 24, 1928 and February 28, 1933 to and for the account of the Debtor (in excess of repayments), the net amount of such advances being $3,082,689.91, and interest thereon. (Of such amount the sum of $1,000,000 in cash was paid by Standard directly to the holders of the notes of the Debtor on account of interest between February 24, 1928 and February 28, 1933, the sum of $597,129.75 was paid by Standard during said period to the preferred stockholders of the Debtor in payment of dividends on their preferred stock duly declared by Deep Rock, and the sum of $1,300,428.98 was paid by Standard to Deep Rock between February 24, 1928 and February 28, 1933, for payment of operating and corporate expenses of the Debtor).

5. On the basis of the record, Standard is also entitled to a claim for interest on indebtedness due to it from the Debtor, the claim for such interest to rank on a parity with the claims for the particular items of indebtedness.

6. On the basis of the record, Standard is also entitled to a claim against the Debtor for the amount of $160,-

945.75, with interest, for dividends on the preferred stock of the Debtor owned by Standard, which dividends were duly and lawfully declared by the Debtor, but which dividends the Debtor failed to pay. Standard is entitled to such claim in seniority to the interests of the public preferred stockholders of the Debtor, who collected such dividends so declared in cash.

7. On the basis of the record, Standard is also entitled to a claim against the Debtor, on a parity with the claims of the holders of notes of the Debtor, for interest on $4,250,000 principal amount of notes of the Debtor, due December 31, 1931, for the period January 1, 1928 to April 12, 1928, with interest thereon to February 28, 1933, and to a claim against the Debtor for dividends of $840,672 duly declared by the Board of Directors of the Debtor, but not paid, with interest to February 28, 1933, and, on a parity with the claims of the holders of notes of the Debtor, for the fair value of the services rendered to the Debtor by Byllesby Engineering and Management Corporation (a wholly owned subsidiary of Standard) between February 24, 1928 and February 28, 1933, with interest to February 28, 1933.

8. Equity requires that Standard recover from the Trustee the possession and control of the Bradstreet Properties and Cracking Plant and fair compensation for the use and occupancy and operation of the Bradstreet Properties and Cracking Plant and by the receiver and by the trustee of the Debtor, and be allowed a claim against the Debtor for the fair value of its use and operation of such properties, unless there be paid to Standard the amount of its cash investment of $2,082,026.30 in Deep Rock Oil and

Refining Company (which owns the Bradstreet Properties and Cracking Plant), with fair compensation for the use of such monies. (Such sum includes the sum of $8,227.94 expended by Standard since February 28, 1933, the date of the beginning of the receivership of the Debtor, for the corporate purposes of Deep Rock Oil and Refining Company.)

9. So much of the order of February 29, 1940, appealed from, as requires Standard to transfer to the Trustee the capital stock of Deep Rock Oil and Refining Company, title to the Bradstreet Properties and Cracking Plant, and the note of the Refining Company held by Standard, is unlawful and is a deprivation of Standard of its property, without due process of law.

10. The District Court had no jurisdiction to adjudicate as invalid the claim of Standard against Deep Rock Oil and Refining Company and to order Standard to surrender, "marked paid", the note of Deep Rock Oil and Refining Company held by Standard.

V. Summary of argument.

For the sake of brevity, reference is respectfully made to the "Reasons for Granting Certiorari" contained in the foregoing petition for certiorari.

VI. Argument.

POINT I.

The decision which petitioner seeks to have reviewed relates to issues not decided by this Court in *Taylor* v. *Standard Gas and Electric Company*, 306 U. S. 307.

The accompanying petition does not represent an attempt to reargue any of the matters decided by this Court in the

Taylor case, nor does it seek an interpretation of the decision of this Court in that case, or to relitigate decided issues. The issues involved in the accompanying petition were not decided by this Court in the *Taylor* case, although both the District Court and the Circuit Court explained the result of which petitioner complains—a result which the District Judge considered inequitable (R. 1314)—as required by the decision of this Court in the *Taylor* case.

In the *Taylor* case, this Court did not adjudicate the merits of Standard's claim, nor subordinate Standard's claim to the amount of the claim of note holders for $10,000,000 principal, plus interest of $4,200,000, (being interest computed at the rate of 6% per annum during the entire period of receivership), and to the claim of the preferred stockholders for $5,000,000 ($100 per share), plus (unearned) dividends of $3,150,000 (at the rate of $7 per share per annum since 1931), before any provision may lawfully be made for Standard's participation as a creditor in the reorganization of the Debtor, nor adjudicate that Standard must transfer to the trustee of Deep Rock the stock and note of the Refining Company, representing a net cash investment by Standard of $2,082,026.30, without receiving compensation or reimbursement.

We do not presume to state to this Court what it decided in the *Taylor* case; we discuss that case only to the extent necessary for the presentation of our arguments. Our discussion comprises three points:

> (1) The scope of the issues decided in the *Taylor* case, for only as to matters within the issues is a judgment conclusive.
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> *Norton* v. *Larney*, 266 U. S. 511, 517, 45 S. Ct. 145, 69 L. Ed. 413, 417 (1925);

North Carolina R. Co. v. *Story,* 268 U. S. 288, 295, 45 S. Ct. 531, 69 L. Ed. 959, 962 (1925);

Doe v. *Carpenter,* 18 How. 297, 302, 15 L. Ed. 389, 391 (1856);

Hill v. *U. S.,* 298 U. S. 460, 466, 56 S. Ct. 760, 80 L. Ed. 1283, 1288 (1936).

(2) Whether the decision in the *Taylor* case adjudicated Standard's interest in the Refining Company.

(3) Whether in the *Taylor* case this Court decided the exact extent of any priorities of note holders and preferred stockholders over the claim of Standard as a creditor.

1. This Court itself stated the question in the *Taylor* case to be "whether, within the bounds of reason and fairness", a division of the equity in the ratio of $4,234,000 to Standard and $1,020,000 to the preferred stockholders (the latter to be without representation on the Board of Directors) could be justified. 306 U. S. 307, 315.* The opinion must be read as an answer to that issue.

***The Circuit Court of Appeals in its first opinion in the *Taylor* case, (before that case reached this Court), also held that: "whether Standard was entitled to the allowance of its claim on the merits is not the issue here presented. That issue was never passed on by the Special Master or the Court. The real issue is whether the plan meets the requirements of Section 77B (b) (e) (f) of the Bankruptcy Act, as amended, 11 U. S. C. A. Section 207 (b) (e) (f), and is fair and equitable, and whether the court abused its discretion in approving the offer of compromise." 96 F. (2d) 693, 703.**

In response to the issue so posed by it, this Court held that the plan of reorganization and concomitant offer of compromise must be disapproved because, under the state of record then before the court, the plan of reorganization (based upon the offer of compromise) "subordinated preferred stockholders to Standard", and held that if a reorganization is effected, control should be divided so that preferred stockholders have at least equal voting right with Standard and a right of participation in the equity prior to that of Standard. This Court expressly did not consider or adjudicate the merits of Standard's claim, and restricted its decision to what "A plan of reorganization * * * (2) may include * * *" (306 U. S. 307, 322). This Court dealt only with the requirement that *the securities which Standard might receive in a plan of reorganization must be subordinate in character to the securities to be allotted to the preferred stockholders, and enjoy no greater voting rights.*

The record that was before this Court in the *Taylor* case had to do solely with the question of whether the plan of reorganization and concomitant compromise approved by the District Court should be reversed. Counsel in that case addressed themselves to the argument of the question of the circumstances under which an order approving a compromise should be reversed, and to the applicability of the so-called instrumentality rule to the claim of Standard, *i.e.*, whether the claim was non-existent because of the application of that rule. The merits of Standard's claim were referred to only incidentally for the purpose of showing sufficient probable validity to sustain a compromise, and not in an attempt to convince this Court that a decision on the merits would unquestionably have been in Standard's favor.

This Court in the *Taylor* case neither rejected Standard's claim on the merits nor denied its probable validity; the *Taylor* case merely held that the participation awarded Standard under the plan of reorganization was excessive and unfair *vis-a-vis* the preferred stockholders.

The opinion of this Court in the *Taylor* case referred to "abuses in management" (306 U. S. 307, 323). A Law Review writer has since commented, in 39 Columbia Law Review 907, 927 (1939)* that:

> "A culling of the record in the case yields no evidence that the management of Deep Rock was inefficient or wasteful. Furthermore, Brief of *Petitioners* states, in speaking of the supervision fees, '* * * Deep Rock's oil business was actually handled by its operating officers who were well experienced in the oil business * * *'."

2. In the *Taylor* case, this Court did not decide whether Standard must be required to transfer its interests in the Refining Company to the Trustee, without receiving compensation or reimbursement. This Court, in its decision in the *Taylor* case, did not decide or even discuss the issue of the ownership of the stock of the Refining Company and the title to and validity of the note of the Refining Company held by Standard.

The facts with respect to the Refining Company transaction, as they appear in the present record, which was

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***Claims Against Affiliated Companies in Reorganization, by Charles Rembar. Mr. Rembar is an attorney presently employed in the Reorganization Division of the Securities and Exchange Commission. We understand that his article was written before he associated himself with the Securities and Exchange Commission.**

not before this Court when the *Taylor* case was submitted, have been summarized at pages 12 to 16 of the accompanying petition. The full benefits of ownership of this property were enjoyed by Deep Rock and not by Standard (R. 313). We have not here a case where a parent seeks to profit at the expense of a subsidiary by taking to itself a corporate opportunity of the subsidiary; on the contrary, Standard paid for property but made it freely and unstintingly available for use by Deep Rock on terms more favorable than terms which Deep Rock could possibly have obtained from a stranger.

Seeking compensation for its investment, Standard entered into certain leases with Deep Rock. These leases are described in the opinion of this Court in the *Taylor* case (306 U. S. 307, 317-319). The relationship between Standard and Deep Rock was such as to permit Deep Rock, or its Trustee, to seek to disaffirm these leases; but such disaffirmance would not in equity deprive Standard of its right to retain its security interest in the property and of its right to receive compensation for the use of its property.

Southern Pacific Company v. *Bogert*, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919);
Thomas v. *Brownville, etc. R. Co.*, 109 U. S. 522, 3 S. Ct. 315, 27 L. Ed. 1018 (1883);
McCandless v. *Furlaud*, 296 U. S. 140, 167, 56 S. Ct. 41, 80 L. Ed. 121, 134 (1935).

In its amended proof of debt filed December 26, 1939 (R. 91) Standard abandoned any claim since 1928 based on the leases of the Refining Company. Even if there had been a disaffirmance and avoidance of the leases by court order, it would not follow that Standard could be

deprived of title to the Refining Company property without compensation. Yet that is what the courts below have attempted to effect. This Court did not so rule in the *Taylor* case.

3. In the *Taylor* case, this Court did not, and on the record before it could not, decide the exact extent of the priorities of note holders and preferred stockholders over the claim of Standard as a creditor.

Nowhere in the opinion of this Court in the *Taylor* case is there any statement with respect to the extent of priority of the claims or interests of note holders and preferred stockholders over the claim of Standard, except, perhaps, in these words: "In the present case there remains an equity after satisfaction of the creditors in which only the preferred stockholders and Standard can have an interest" (306 U. S. 307, 323).

Inferentially, if this sentence be removed from its context in the opinion, it may mean that the note holders are entitled to a priority over Standard. Actually, the plan of reorganization before this Court in the *Taylor* case was one in which Standard had agreed to the issuance of a senior security to the note holders; therefore, the issue before this Court, as stated by it, was "whether, within the bounds of reason and fairness", a division of the remaining equity of $5,800,000 in the ratio of $4,234,000 to Standard and $1,020,000 to the preferred stockholders (without representation of the preferred stockholders on the Board of Directors) could be justified (306 U. S. 307, 315). We believe that the opinion must be read as an answer to that question.

The record before this Court in the *Taylor* case precluded not only a decision by this Court of Standard's

claim on its merits, but also a consideration by this Court of all the equities which might determine the degree of subordination in the absence of a new plan of reorganization. Without seeking at this point to state the arguments in support of the proposition that equity requires that Standard as a creditor be awarded a participation in the reorganization of the Debtor (see Points II and III, *infra*), we point out that from the record in the *Taylor* case were absent the facts relative to the acquisition by large numbers of Deep Rock's security holders of their interests in the Debtor at prices representing fractions of the face amounts of their securities, a matter relating directly to the issue of whether equity will permit the unjust enrichment of such persons at the expense of Standard and its fifty-eight thousand security holders. This issue involves not the question of the enforceability of a contractual claim of a note holder or stockholder against the company with which he has made his contract; rather what is sought to be accomplished by the note holders and preferred stockholders here is, in effect, the enforcement of a claim against *Standard,* with whom they had no contractual relationships. Any such claim which may be enforced must be one subject to equitable considerations.

The failure of the courts below to give any effect at all to the pertinent equitable considerations, based on their erroneous assumptions that the decision in the *Taylor* case precluded them from so doing, will not bar this Court. This Court will not permit its opinion to be used as an "instrument of * * * injustice". *Thomas* v. *Brownville etc. R. Co.,* 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018, 1020 (1883).

POINT II.

The decision excluding Standard as a creditor from participating in the reorganization of Deep Rock is inequitable and violates the doctrine expressed in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483.

Equitable considerations render impossible any justification of the decision of which petitioner complains. It is notable that the District Judge rendering the decision considered it inequitable (R. 1314) and made no effort to justify it. As we have pointed out above, neither the District Court nor the Circuit Court attached any weight to equitable considerations.

In its opinion in the *Taylor* case, this Court referred to the broad equitable principles expressed in *Southern Pacific Company* v. *Bogert*, 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919). Petitioner believes that the principle expressed in that case governs and should determine this case. We quote from that opinion, 250 U. S. 483, 496, 497:

> "Some adjustment should obviously be made so as to compensate the Southern Pacific for any contribution made at its expense to the value of the stock in the new company of which the minority stockholders may get the benefit. *The purpose of this proceeding is not to punish the Southern Pacific, but to declare and enforce its obligation as trustee. The minority stockholders who seek equity should do equity; and a court of chancery has power in granting relief to prevent unjust enrichment of the minority stockholders at the expense of the Southern Pacific.*" (Italics ours.)

In *Thomas* v. *Brownville etc. R. Co.*, 109 U. S. 522, 526, 3 S. Ct. 315, 27 L. Ed. 1018 (1883), this Court required

those who sought equitable relief to do equity, compelling the applicants for relief "to pay fair prices for what they have received". This Court recognized in the *Thomas* case that *"any other terms would be unjust and would make the court the instrument of this injustice."* (Italics ours.)

We know of no doctrine or decision which detracts from the correctness or fundamental justice of the principle laid down by this Court in these cases. No attempt was made in either the District Court or in the Circuit Court to suggest that the decision of which petitioner complains meets the standards set forth in the *Bogert* case; on the contrary, the District Judge, as we have shown, considered that his decision was unjust (R. 1314). It was erroneously assumed by the District Court (R. 1317) and by the Circuit Court of Appeals that, by its opinion, this Court—the Supreme Court of the United States—prevented an equitable result and compelled a penal result!

A brief consideration of the equities in Standard's favor which would militate against any subordination of Standard's claim to the extent provided in the orders below, is in order:

1. Standard's cash investment in the Debtor, exceeding the sum of $20,000,000 (R. 1270), is more than the aggregate combined investment in the notes of the Debtor at the principal amount thereof ($10,000,000) and of the preferred stock of the Debtor at the "par" value thereof in liquidation ($5,000,000). The real parties in interest are Standard's fifty-eight thousand innocent security holders.

Duffy v. *Treide*, 75 F. (2d) 17, 19 (C. C. A. 4th, 1935);

In re Van Camp Products Co., 95 F. (2d) 206, 209, 210 (C. C. A. 7th, 1938) cert. den. 305 U. S. 605, 59 S. Ct. 65, 83 L. Ed. 384 (1938);

Cf. Jackson v. *M. H. Thomas Inv. Co.*, 46 F. (2d) 252, 254 (C. C. A. 5th, 1931);

Cf. also *Rapid Transit Subway Constr. Co.* v. *City of N. Y.*, 259 N. Y. 472, 491 (1932).

2. There is no evidence in the record that actual damage has been suffered or incurred by the note holders or preferred stockholders of the Debtor as a result of any act or omission on the part of Standard; or, conversely, that Standard has in fact enjoyed any profit from its relationships with the Debtor. The amended proof of debt excludes any claim for rentals of the Refining Company property, and submits to the court the question of the amount to be allowed for services rendered by the Management Corporation. Petitioner eliminated the rental items after consideration of the comments of this Court in the *Taylor* case. A law review writer has found that there was no evidence in the record of inefficient or wasteful management of Deep Rock or that the note holders or preferred stockholders were ever deprived of any money or of any property of value for the benefit of Standard. Rembar, "Claims Against Affiliated Companies in Reorganization", 39 Columbia Law Review 907 (1939).

3. Since the beginning of the receivership proceedings, the notes of the Debtor have been purchased in large amounts at great discounts from the face amount thereof (R. 133-137, R. 150); and although the holders of some

30% of notes and of 28% of the preferred stock of the Debtor failed to comply with the order of the District Court requiring them to file a statement of their cost (R. 133), it is only reasonable to assume that such holders have a cost substantially below the principal amount of such notes or the capital value of the preferred stock, and undoubtedly substantially below the average prices reported to the Court. The record shows the market prices at which these securities were traded in during the receivership period (R. 134-137). Those persons who acquired notes and preferred stock during the receivership and reorganization period (and certainly those who acquired them prior to the decision of this Court in the *Taylor* case) had full knowledge of the Debtor's financial difficulties, knew that they were buying securities which had not paid interest since the beginning of the receivership, and undoubtedly assumed that Standard's claim was valid and enforceable.* *Any* profit to such note holders and preferred stockholders resulting from a decision of this Court in the *Taylor* case would be in the nature of a windfall. Should this windfall go to the unconscionable extent of rewarding such purchasers of notes of the Debtor to the extent of paying them the principal amount of their notes plus interest during the entire receivership period at the rate of 6% per annum on the principal (not on cost or market values!) and subordinating Standard as a creditor to the full priorities in liquidation of the preferred stockholders including dividends accrued during the reorganization proceedings at the rate of $7 per share per annum?

***It must be remembered that the plan of reorganization which was reversed by this Court in the *Taylor* case in February 1939 had the affirmative approval of the holders of 82% of the notes and of 60% of the preferred stock.**

It cannot be argued in good faith that a doctrine which would avoid the harsh rule applied by the order complained of would impair the marketability of defaulted securities; for here, as we have pointed out, there is no question of the right of enforcement according to its tenor of defaulted securities against the issuer: *the question here simply is the extent of the windfall to accrue to the holders of such securities as a result of equitable considerations which require some debasement of the status of a creditor whom they presumed to be entitled to its full legal rights when they acquired their securities.*

4. A further consideration, which bears on the equity of excluding Standard from participation, is the speculative character of oil property, about which Judge Huxman, in the Circuit Court of Appeals, commented "It must also be borne in mind that the assets of Deep Rock consisted of oil property and leases, property that fluctuates greatly and increases rapidly in value," (R. 1377). A similar observation was expressed by the District Judge (R. 1312, f. 1815).

We mention the figures and testimony below for the purpose of emphasizing the inequitable result which would forever preclude Standard from sharing in the highly speculative earnings of Deep Rock, which has indicated a vast earning capacity.

The margin of error in evaluating oil properties is tremendous; one witness supporting the valuation (Mr. Francisco) testified that net earnings might be capitalized at eight to fifteen times their amount (R. 1205). Mr. Berend, another witness supporting the valuation, testified that the method of capitalizing net earnings, suggested by Mr. Francisco, was a method which he had not seen

applied in his thirty years in the oil business (R. 1226). Mr. Francisco testified that the appraisal relied on by the Court was based on a speculation as to the amount of oil to be recovered in the future and on the hypothetical price of $1 per barrel for oil in the future, the current price being $1.02 (R. 1210). The same witness testified that in his experience there is a large difference between actual recovery of oil reserves and estimates (R. 1210).

Mr. Berend testified that a new appraisal might show a difference of 10% to 15% one way or the other from the appraisal filed in Court (R. 1215).

It is important to note that the earnings of the Debtor during reorganization have been substantial; and that the properties of the Debtor have been improved substantially during the receivership period, according to the undisputed testimony of Mr. Greis, the Trustee (R. 1252). For the five years 1935-1939, total adjusted earnings from operations amounted to $10,064,292.20, making the average annual adjusted earnings from operations $2,013,858.44 (R. 1350 B). These earnings are subject to depletion and depreciation charges, estimated by the Trustee to average $1,230,136.13 annually, and to other charges, including interest on pre-receivership debt and income taxes. The net earnings before interest and federal income taxes, after all depletion and depreciation and all other charges, average $538,747.22 during each of the five years in question, reaching a high figure in 1936 of more than $1,000,000 (R. 1350 B). In view of the hypothetical assumption of a $1 price for oil in the future, and in view of present world conditions, the speculative possibilities of a great increase in Deep Rock's earnings bear directly on the equity of forever excluding Standard and unjustly enriching speculators in Deep Rock's securities.

As long as Deep Rock's vast speculative resources remain unexploited, Standard should have a right of participation; the cut-off date of Standard's interest as a creditor should not be the date of confirmation of a plan of reorganization under the circumstances of this case.

5. There are further equitable considerations, more amply considered in Point III below, such as the fact that among the items comprehended in Standard's amended proof of debt are the sum of $1,000,000, which Standard paid directly to the note holders of the Debtor, on account of note interest, and the sum of $597,129.75 which Standard paid to the public preferred stockholders of the Debtor on account of preferred dividends. There are the further facts (set forth more fully below) with respect to the Refining Company properties: that Standard has a net cash investment of more than $2,000,000 in such properties, for the use of which it has received no compensation and by the use of which the Debtor has been enriched to the extent of many millions of dollars (p. 64, *infra*).

We submit that the pertinent equitable considerations require that Standard be granted a participation in the reorganization of the Debtor, and that the courts below erred in deliberately refusing to do equity.

POINT III.

Standard has established a valid claim on the merits.

The existence of some valid claim in favor of Standard against Deep Rock is not challenged; indeed in the order signed by the District Judge, the fact is substantially admitted (R. 160). Petitioner asserts further that it has made out a prima facie case at the very least. *Cf. Whitney* v. *Dresser,* 200 U. S. 532, 26 S. Ct. 316, 50 L. Ed. 584

(1906). Such burden of proof as is imposed by the doctrine of *Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590, 41 S. Ct. 209, 65 L. Ed. 425 (1921), was fully met.

The constituent portions of the amended claim are set forth at page 100 of the Record. A brief description of the items of the amended proof of debt will show the reasons why Standard has been aggrieved by the decisions below. We also show, in the case of each item, the impact of the pertinent special equitable considerations.

1. Standard's right to a claim for net cash advances.

Petitioner asserts that it is entitled to a claim against the Debtor, on a parity with the notes of the Debtor, in the amount of $3,082,689.91 representing cash advanced by it to the Debtor and to others for the account and benefit of the Debtor between February 24, 1928 and February 28, 1933 (the date of the inception of the receivership proceedings), over and above all cash received by Standard from or for the account of the Debtor during said period, plus interest at the rate of 7% per annum, compounded monthly from the first day of the month following each charge or credit upon such cash items to February 28, 1933, amounting to the sum of $765,242.20.

As to such cash advances, no issue is raised by the record whether petitioner, in making cash loans to the Debtor or cash payments to strangers for the account of the Debtor, had any interests conflicting with those of the Debtor; nor is there the slightest doubt from the evidence that petitioner paid out the money, that of the money so paid out during the period included in the amended proof of debt, $1,000,000 was paid directly to the note holders of the Debtor, and $597,129.75 to the public preferred

stockholders of the Debtor (R. 1269). These are *net* cash advances, over and above repayments; it cannot be discerned from any evidence in the record that Standard received any reward or benefit as a result of such advances. To the extent of these sums, at least, *it would shock the conscience of a court of equity if the recipients were permitted to deny to Standard a claim at least on a parity with the claim they would have had against the Debtor had Standard failed to provide the necessary funds for payment to them.*

The record shows also that the sum of $1,300,428.98 of the total of $3,082,689.91 was used for operating purposes of the Debtor during the period in question, thus conferring a direct and immediate benefit on the note holders and preferred stockholders of the Debtor.

> *Cf. Virginia & Ala. Coal Co.* v. *Central R. & B. Co.,* 170 U. S. 355, 18 S. Ct. 657, 42 L. Ed. 1068 (1897).

There is no issue as to whether these advances were beneficial or detrimental to the Debtor—obviously they were of benefit to the Debtor, to its note holders and to its public preferred stockholders who received a large portion of the money. Standard received no moneys or property in return for its payments; the benefits enjoyed by it as a stockholder would have been the same whatever the source of the loans to Deep Rock. If avoiding receivership or liquidation that might have followed a default is a great benefit, how much greater was the benefit to the holders of notes and preferred stock who received cash and who were not demonstrably prejudiced in any way!

2. Standard's right to interest on its loans.

Standard claims to be entitled to interest on the above described advances at the rate of 7% per annum. The testimony now before the court shows conclusively and indisputably that Standard's actual cost of the use of money during the period in question exceeded the rate of 7% per annum compounded monthly (R. 1268). Conceding a power on the part of the Court as a court of equity to disallow any inequitable charges because of the relationship between Standard and the Debtor, it is submitted that the charge for interest made by Standard to the Debtor was not inequitable since Standard's own cost of the use of money for the period involved exceeded the amount charged, and since there is no proof whatever, and little probability, that the Debtor could have borrowed on more favorable terms from other sources. Further light on the equities is cast by the fact that the payments to note holders not only relieved the Debtor of the consequences of a default (which would have been detrimental to its preferred stockholders at least), but also of a charge of 6% per annum, compounded semi-annually. Payment of dividends to preferred stockholders avoided an accumulation of dividends at the rate of $7 per share per annum.

3. Standard's claim for debt due to dividend declarations (a) on preferred stock, and (b) on common stock.

a. The amount of Standard's claim based on dividends declared but not paid on preferred stock of the Debtor, owned by Standard, ought to stand either on a parity with the notes, or at the least, in a position superior to the claim of the preferred stockholders of the Debtor. We submit that, in the record now before the court, it is ade-

quately proven that the dividends were declared with the best interests of Debtor in mind and not with any intention of evading the minor and inconsequential voting rights of preferred stockholders (R. 1299-1301). The right to dividends is a full fledged debt of the Debtor entitled to full equality with any other claims.

All holders of preferred stock other than Standard have collected their dividends in cash. If the Court has the power to subordinate to some degree Standard's claim based on the declaration of such preferred stock dividends (amounting to $160,945.75, and interest thereon to the date of the inception of the receivership proceedings, amounting to $64,586.25), to the claims of creditors of the Debtor, in no event should such subordination have the effect of depriving Standard of a position enjoying priority over the preferred stock of the Debtor. If equity requires subordination of this amount to the claims of note holders, it would be manifestly inequitable for the preferred stockholders of the Debtor, who have collected their dividends in cash in full, to urge that Standard, which enjoyed a position precisely similar to theirs as a preferred stockholder, should not be entitled to a claim which they would have had had there been a failure to pay such dividends in cash following such declaration.

b. As to the item of claim based on dividends declared but not paid on the common stock of the Debtor owned by Standard, amounting to $840,672.00, with interest thereon of $277,224.93 to February 28, 1933: the record shows that these dividends were declared with Deep Rock's and only Deep Rock's interest in mind (R. 1300); that although payment of such dividends in cash would have involved recourse to further borrowing, it was to Deep Rock's interest,

from a credit point of view, to maintain a dividend paying record; and that dividends were declared out of earnings (R. 1299-1300). It is clear from the record that it was not because of Standard's paramount interest as a common stockholder that dividends on the common stock were declared; therefore the Court should not exercise its equitable power to subordinate this item of claim to the claims of creditors and interests of preferred stockholders.

The legal issues involved in the declaration of these dividends were submitted to this Court in the *Taylor* case and not decided. We do not here repeat the legal arguments except to note that the declaration of dividends in face of the need to borrow funds for payment is not necessarily born of improper motives.

Alabama Consolidated Coal & Iron Co. v. *Baltimore Trust Company,* 197 Fed. 347 (D. C. Md. 1912);

Cf. People of Colorado ex rel. Fraser v. *Great Western Sugar Company,* 29 F. (2d) 810 (C. C. A. 8th, 1928);

Splittgerber Bros. v. *Skinner Packing Co.,* 119 Neb. 259, 228 N. W. 531 (1930);

Wittenburg v. *Federal Mining & Smelting Co.,* 15 Del. Ch. Rep. 351, 138 Atl. 352, 55 A. L. R. 39 (1927).

4. Standard's claim to interest on securities of the Debtor.

As to the item of claim based on interest on $4,250,000 principal amount of Deep Rock 6% Gold Notes due December 31, 1931, amounting to $72,958.33 with interest of $29,799.93 to February 28, 1933: the record shows that the principal amount of the notes was contributed to Deep

Rock's capital in April 1928, accrued interest remaining unpaid (R. 353). Equity certainly does not require Standard to cancel or reduce interest which accrued prior to the date of cancellation of the principal of the debt. Standard asserts that as to this item and interest thereon, it is entitled also to a position of parity with the creditors of the Debtor.

5. Standard's claim based on services rendered by the Management Corporation.

As to the item of claim based on credits to Byllesby Engineering and Management Corporation, representing an assignment to Standard of amounts due and owing from Deep Rock to Byllesby Engineering and Management Corporation for services, to wit, $720,000 and interest thereon to February 28, 1933 in the amount of $166,462.98: the record shows that valuable technical, accounting, engineering, financial, purchasing, fiscal, etc. services were rendered by the Byllesby Engineering and Management Corporation to Deep Rock (R. 187, 188, 242, 243, 250-253, 310, 323, 342-347, 461) for which Deep Rock would have had to pay. Equity requires that there be assessed against Deep Rock the reasonable amount which Deep Rock would have had to pay to others for the services performed by Byllesby Engineering and Management Corporation. Equity may permit the court to deny or to subordinate so much of the charges of Byllesby Engineering and Management Corporation as represent any unfair profit which it is sought to enforce against Debtor.*

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*See *United Light & Power Company* v. *Grand Rapids Trust Co.*, 85 F. (2d) 331, 337 (C. C. A. 6th, 1936). In that case the Circuit Court held:

> "We think it is going too far to say that such contracts made by a corporation with its sole stockholder are void (citing cases) but, because they involve the

The amount of the charge which should be allowed to Standard was respectfully submitted to the District Court for decision. The Court refused to decide the question, although from the record it was clear that Byllesby Engineering and Management Corporation had maintained a large and expert organization available on call of the Debtor, and had rendered to the Debtor engineering, operating, financial, auditing, insurance, publicity and other services of value; all these services were needed by Deep Rock; one of the benefits enjoyed by Deep Rock was the benefit of discounts on purchases made by it through the facilities available to Byllesby Engineering and Management Corporation (R. 314, 315). Some allowance should in equity be made for this item.

We submit that the District Court should have considered each of the items in the amended proof of debt, the proof offered in support thereof, the absence of contradictory evidence, and should have tested the allowability of each item by the principles of equity; and upon such considerations, we submit Standard has proved a valid claim on the merits, and is entitled to participation as a creditor in the reorganization of the Debtor.

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relationship between the railway and its sole stockholder, they will be carefully scrutinized to see that they do not divert the assets of the railway to the stockholder without consideration. * * * Still, some services were rendered. * * * Intricate and extensive blueprints were prepared; savings were effected in insurance and in purchases of equipment and supplies. All this was worth something, and there is no substantial reason for disagreeing with the findings of the District Judge."

POINT IV.

Accrued interest of $4,200,000 on the notes of Deep Rock and accumulated dividends of $3,150,000 on its preferred stock (all of which accrued since the inception of the proceedings) may not properly be taken into consideration in determining the amount of the financial interests enjoying seniority over Standard.

The elimination of interest and dividends which have accrued since the inception of the proceedings leaves an equity of at least $2,449,000 for Standard, even assuming (without conceding) that the note holders and preferred stockholders are entitled to priority over Standard to the extent of $10,000,000 and $5,000,000 respectively, a total of $15,000,000. This computation is based on the valuation of $17,449,788.54 found by the District Court (R. 1311). Such a result would give to the *Taylor* case the effect of subrogating the preferred stockholders of the Debtor to the first $5,000,000 of Standard's interest as a creditor.

Petitioner submits that for the purpose of determining the amount of interest, if any, which should be computed on the claims of the note holders, the courts below should first have added the principal amount of the claim of the notes ($10,000,000) to the principal amount of Standard's claims, in order to determine whether the Debtor is solvent, allowing interest accruing after the inception of the proceedings only out of any excess over the sum of these debts. If the assets of the Debtor are insufficient to pay the principal amount of the claims against the estate as they existed on the date of the inception of the court proceedings, interest ought not to be calculated in favor of any creditors.

In this case, the sum of the claims at the beginning of the proceedings exceeds the value of the assets, taking into account the interest of Standard in the Refining Company.

The rule in bankruptcy proceedings is clear that interest will not accrue after the institution of proceedings for the purpose of determining the respective amounts of claims to free assets as between creditors.

Sexton v. *Dreyfus,* 219 U. S. 339, 31 S. Ct. 256, 55 L. Ed. 244 (1911);

Merrill v. *National Bank of Jacksonville,* 173 U. S. 131, 19 S. Ct. 360, 43 L. Ed. 640 (1899);

Thomas v. *Western Car Co.,* 149 U. S. 95, 13 S. Ct. 824, 37 L. Ed. 663 (1893);

Cf. American Iron & Steel Mfg. Co. v. *Seabord Air Line Ry.,* 233 U. S. 261, 34 S. Ct. 502, 58 L. Ed. 949 (1918).

This rule has been taken over in statutes, and is also part of the law of equity receivership.

Merrill v. *National Bank of Jacksonville, supra;*

Cf. Ticonic National Bank v. *Sprague,* 303 U. S. 406, 58 S. Ct. 612, 82 L. Ed. 926 (1938);

American Iron & Steel Mfg. Co. v. *Seabord Air Line Ry., supra;*

Thomas v. *Western Car Co., supra;*

Gamble v. *Wimberly,* 44 F. (2d) 329 (C. C. A. 4th, 1930).

While this rule has been described as a "rule of distribution", it has also been supported on the ground that no

person should gain an advantage resulting from the delay incidental to administration of assets by courts of law.

Attorney General v. *Supreme Council,* 206 Mass. 131, 92 N. E. 131 (1910);
People v. *American Loan & Trust Co.,* 172 N. Y. 371, 65 N. E. 200 (1902);
Tredegar v. *Seaboard Air Line Ry.,* 183 Fed. 289 (C. C. A. 4th, 1910).

This rule has been applied even though there were different rankings of priority among the unsecured creditors of the insolvent Debtor.

Solomon's v. *American B. & L. Association,* 116 Fed. 676, aff'd. 120 Fed. 1018 (C. C. A. 5th, 1903);
Atlantic National Bank v. *Four-States Grocery Co.,* 135 S. W. 1135 (Tex. Civ. App. 1911);
Hanson, Effect of Insolvency Proceedings on Creditors Right to Interest (1934), 42 Mich. L. Rev. 1069, 1071:

> "Where some of the claims are entitled to priority of payment, the general rule is that interest will not be computed and paid thereon unless the principal of all claims can be paid in full."

The reorganization statutes are bankruptcy laws and are founded upon the bankruptcy power of Congress.

Continental Ill. N. B. & T. Co. v. *C. R. I. & P. R. Co.,* 294 U. S. 648, 55 S. Ct. 595, 79 L. Ed. 1110 (1935).

In its opinion in this case, the Circuit Court stated that creditors holding prior liens are entitled to interest to the date of the payment out of the proceeds derived from property recovered from such lien (R. 1377). Neither the note holders nor preferred stockholders have a lien on any property in this proceeding; and the cases cited by the Circuit Court in support of its proposition are cases where prior lienors or tax claimants, enjoying a special status, were involved. They are not relevant here.

Preferred stock dividend accruals of $7 per share per annum should not be permitted during a period of administration of an estate by a court, particularly if not earned. We are not urging a repudiation of the Debtor's contract or of Standard's contract as a common stockholder; what we are talking about is the question of whether equity will permit subordination of Standard's position as a creditor to an accrual of $7 per share per annum of dividends on the preferred stock, even though not earned, while the estate is in process of administration by the court. We can see no equity in such a result.

Based on market prices of Deep Rock securities prevailing during the proceedings (R. 134-137), 6% per annum on the principal amount of notes and $7 per share per annum on the preferred stock result in fantastically high rates of interest.

It is respectfully submitted, therefore, that in any event, even assuming that the note holders and preferred stockholders must be accorded a prior position, an equity of about $2,500,000 remains in which Standard has an interest and of which Standard may not be lawfully deprived under the Bankruptcy Act.

If the actual prices at which note holders and preferred stockholders of the Debtor acquired their securities be

taken into account and if the sum of those prices be the amount to which Standard's claim should be subordinated, Standard's equity will necessarily exceed the sum of $2,500,000; the amount of the discounts from principal amount of notes and from $100 per share for the preferred stock, on the basis of the prices of these securities since March 1, 1933, as set forth in the Record at pages 134-137, aggregate many millions of dollars and would increase the amount of equity available to Standard. We submit that the amount to which Standard's claim may be subordinated in equity should never be greater than the actual consideration paid by the note holders and preferred stockholders for their claims and interests. While the record does not contain evidence to support a complete mathematical calculation of such aggregate cost (many security holders having failed to comply with the order of the District Court), on the basis of the reports submitted to the court as to securities acquired before and after the inception of the proceedings, it is a reasonable assumption that the equity remaining for Standard would be enough to satisfy most, if not all, of its claim.

POINT V.

So much of the order of February 29, 1940 as directs Standard to transfer to the Trustee of the Debtor the stock of the Refining Company and the note of the Refining Company "marked paid", without receiving any compensation for or reimbursement of its investment of $2,082,026.30, is an unlawful taking of Standard's property without due process of law.

The essential facts respecting the interest of Standard in the Refining Company are set forth in the accompanying petition for certiorari (*supra*, pp. 12-16).

From the record, it is clear that numerous and great financial benefits were enjoyed by the Debtor as a result of the Refining Company's properties (R. 313). Prior to 1925, the Debtor enjoyed from the operation of the Bradstreet Properties profits of $789,649.19 before retirements and $659,879.10 after retirements (R. 312, 467); in addition, during the same period, Deep Rock enjoyed profits from the operation of the Cracking Plant, the aggregate of such profits prior to October 1925 being $829,749.69 (R. 467). Thus, prior to the lease in 1925, Deep Rock enjoyed earnings from the Refining Company properties aggregating $1,619,398.88. Thereafter, Deep Rock has enjoyed further profits from the operation of the Refining Company (R. 891, 892), the amount of net earnings, disregarding rentals but after retirements of approximately $1,400,000, being the immense sum of $2,910,140.55, up to the beginning of the receivership (R. 891, 892). Deep Rock's earnings from the Refining Company's properties, prior to the beginning of these proceedings and before deduction of rentals, amounted to $4,529,539.43.

Since the beginning of the receivership, Deep Rock has continued to operate these properties and they have shown operating profits in operations (R. 1333). All these benefits have been enjoyed at Standard's cost. During the period ending December 31, 1932, depreciation and depletion accruals, "computed in accordance with provisions of the Federal income tax law and regulations," aggregated $3,208,349.81 (R. 821, 822). Further depletion and depreciation necessarily have been incurred during the reorganization proceedings (R. 1335).

Petitioner submits that the record justifies fully its contention that its property interests in the Refining Company cannot be destroyed without its being awarded fair com-

pensation. It is one thing to say that the leases described in the opinion of this Court in the *Taylor* case may be subject to disaffirmance at the instance of the Trustee of the Debtor; it is not the same thing to say that if the leases be disaffirmed, Standard, nevertheless, must surrender without compensation property representing a net cash investment on its part of $2,082,026.30. Deep Rock has enjoyed the benefits and has profited immensely from Standard's investment in the Refining Company. Standard is not seeking and never sought to avail itself of a corporate opportunity of Deep Rock nor to profit at Deep Rock's expense; it simply made a purchase, of which Deep Rock enjoyed all the benefits, Standard retaining title to the property to protect its own security holders. If Deep Rock needs this property it has a right to own it provided that it reimburse Standard on a fair basis.

The District Court failed to give any consideration to Standard's petition, saying "I am trying to fix it so you will get your appeal" (R. 1317). The Circuit Court did not mention this matter at all in its opinion. Opportunity to be heard on the petition was thus denied in the District Court, and even in the Circuit Court of Appeals, where the Court acted on a motion to dismiss the appeal and heard no argument on the merits. Due process requires an opportunity to be heard and to have judicial findings based on the hearing. These the District Court refused with relation to the Refining Company petition of January 29, 1940; and such refusal was a denial of due process.

Blackmer v. *United States,* 284 U. S. 421, 438, 52 S. Ct. 252, 76 L. Ed. 375, 383 (1932);

Baltimore & Ohio RR. Co. v. *United States,* 298 U. S. 349, 368, 369, 56 S. Ct. 797, 80 L. Ed. 1209, 1224 (1936)

American Surety Co. v. *Baldwin,* 287 U. S. 156, 168, 53 S. Ct. 98, 77 L. Ed. 231, 239 (1932);

Powell v. *Alabama,* 287 U. S. 45, 68, 69, 53 S. Ct. 55, 77 L. Ed. 158, 170 (1932).

Petitioner contends that the result of that part of the order which it is sought to have reviewed which relates to the Refining Company is a deprivation of petitioner's property without compensation. The bankruptcy power is subject to the Fifth Amendment.

Louisville Jt. Stock L. B. v. *Radford,* 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593 (1935).

The result is obviously contrary to the principle of *Southern Pacific Company* v. *Bogert,* 250 U. S. 483, 39 S. Ct. 533, 63 L. Ed. 1099 (1919). It is contrary to the fundamental concepts of law and equity that any person's property may be arbitrarily taken for the use of another without compensation; if equity requires that Deep Rock have title to the Refining Company assets, it also requires that Standard receive just reimbursement and compensation; otherwise equity would be the unwitting means of effecting an unjust enrichment.

The arbitrary character of the decision below is evidenced by the order requiring Standard to mark "paid" the note of the Refining Company for $1,894,592.11 and to surrender such note to the trustee. Standard never received payment of such note; the direction to mark "paid" and transfer the note is not conditioned on payment: a fictional transaction has been ordered! Neither the note itself nor the Refining Company was before the Court, and no jurisdictional basis existed for either the direction to

mark "paid" or for the adjudication that the note was invalid. No pleading before the Court submitted the issue of validity of the note or the question of whether it should be marked paid. Jurisdiction is a prerequisite of due process.

CONCLUSION

We submit that the decisions of the Circuit Court of Appeals and of the District Court are erroneous as a matter of law. It is respectfully submitted that the grave injustice to fifty-eight thousand public security holders with an investment of upwards of $20,000,000, as well as the asserted reliance on an opinion of this Court to explain an injustice and inequity (which the District Judge admitted), and the departure by the courts below from the accepted standards of equity and justice should warrant this Court in granting certiorari in the instant case.

Dated: September 26, 1940.

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